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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1971

No. 71

In the Matter of TENNESSEE CENTRAL RAILWAY COMPANY, Debtor,
THE METROPOLITAN GOVERNMENT OF NASHVILLE AND
DAVIDSON COUNTY, TENNESSEE,
Petitioner,

v.

A. BATTLE RODES, Trustee of Tennessee
Central Railway Company, et al.,
Respondents.

PETITION FOR A WRIT OF CERTIORARI

**To the United States Court of Appeals
for the Sixth Circuit**

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To the United States Court of Appeals for the Sixth Circuit

OPINIONS BELOW

The opinion of the Court of Appeals and the opinion of Judge Paul C. Weick dissenting from the denial of rehearing are not yet officially reported, but are set out in the Appendix to this petition at pages A-1, A-16.[1] The

[1] The opinion of Judges Edwards and Peck, two members of the original panel assigned to this case, was filed February 2, 1972. The third member of said original panel, Judge Henry L. Brooks, died while the case was under consideration, on December 30, 1971. On the petitions to rehear, Judge Paul C. Weick was appointed to fill out the panel.

opinion of the District Court is set out in the Appendix at page A-21, and is reported at 316 F. Supp. 1103. The judgment of the District Court is set out in the Appendix at page A-47.

JURISDICTION

The opinion and order of the United States Court of Appeals for the Sixth Circuit was entered on February 2, 1972 (Appendix, p. A-1); a timely petition for rehearing was denied on April 4, 1972 (Appendix, p. A-53). The jurisdiction of this Court is invoked under 28 U.S.C., § 1254(1).

QUESTIONS PRESENTED

1. Did the repeal, in the Reorganization Act of 1966,[2] of 15 U.S.C., § 603, which expressly denied governmental priority under § 3466 of RFC loans of the type herein involved, nine years after the abolition of the RFC,[3] and nine years after the transfer of RFC notes to the Secretary of the Treasury, suddenly endow such RFC notes with a priority status non-existent over the years?

2. In any event, is § 3466 (31 U.S.C., § 191) applicable to railroad organization proceedings under § 77 of the Bankruptcy Act?

3. Whether the mortgage claim of the Appellant, the United States Government, is entitled to prevail over the tax liens of local taxing jurisdictions.

4. Whether 1967 Metropolitan Government ad valorem taxes assessed against the Tennessee Central Railway

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[2] Pub. L. 89-554, § 8(a) (Schedule of Laws repealed), Sept. 6, 1966, 80 Stat. 378; (Recodification of Title 5).

[3] Reorganization Plan No. 1, 1957, June 30, 1957, 22 F.R. 4633, 71 Stat. 647.

Company can be considered administration expenses; and if so, whether such administration expenses would prevail over the United States Government's claim under R.S. 3466 (31 U.S.C., § 191) and its mortgage claim.

STATUTES INVOLVED

The relevant sections of § 77 of the National Bankruptcy Act (11 U.S.C., § 205); § 3466 (31 U.S.C., § 191); 15 U.S.C., § 603; and the relevant sections of Reorganization Plan No. 1 of 1957, effective June 30, 1957, 22 F.R. 4633, 71 Stat. 647, are set forth in the Appendix, pages A-54-A-60.

STATEMENT OF THE CASE

On December 14, 1967, Tennessee Central Railroad filed a petition for reorganization under Section 77 of the Bankruptcy Act, thus invoking the jurisdiction of the United States District Court for the Middle District of Tennessee, Nashville Division. On September 22, 1969, the Trustee of the Debtor petitioned the District Court to determine, *inter alia*, the order of priority of various claimants. After a hearing the Court concluded that petitioner herein, claiming recovery for 1967 ad valorem taxes assessed against the Tennessee Central Railroad Company, had priority over a claim asserted by the United States arising out of a loan to the Debtor by the Reconstruction Finance Corporation (R.F.C.)

In April of 1937 the R. F. C. loaned the Tennessee Central Railroad Company $5,000,000.00, the loan secured by first mortgage bonds of the railroad company. Induced by promises from the Tennessee Valley Authority (T.V.A.) of substantial coal purchases in coal fields of Putnam County, Tennessee, the Tennessee Central, in 1953, with the aid of further loans from the R.F.C. in excess of $2,-

000,000.00, bought substantial additional rolling stock and constructed an expensive line. Shortly thereafter T.V.A. discontinued its coal purchases.

In January, 1967, the United States Government extended the due date of its loans to December 31, 1967. At this time the United States Government was bound to have had full knowledge of the precarious financial condition of the Tennessee Central Railroad Company. Along with many other companies, it was the policy of the Tennessee Central Railroad Company to postpone payment of its Metropolitan Government taxes until immediately prior to, or shortly after, the delinquency date, 1 March, in order to retain the use of these funds for the longest possible time. For instance, in the years immediately prior to the year in question the Tennessee Central Railroad Company paid its Metropolitan Government taxes on the following dates:[4]

1964 taxes—Paid 26 February, 1965

1965 taxes—Paid 1 March, 1966

1966 taxes—Paid 7 March, 1967

The District Court held that the petitioner and certain other claimants were entitled to priority, stating:

> "Tennessee law grants these taxing units a 'first lien' on the property of the Tennessee Central. It is stated in 5 **Collier on Bankruptcy** (14th ed.) ¶ 77.21 that: 'Whenever tax claims are accorded a priority, even under 31 U.S.C. § 191, they will not supersede valid liens, or the priorities accorded administrative and operating costs or claims under the six months rule.' Therefore, the municipalities and counties

---

[4] These payment dates are set forth in an affidavit, executed by Paul R. Startup, Assistant Metropolitan Collections Officer, on 20 November, 1969. This affidavit was filed as part of the record, but is not included in the Joint Appendix.

should not be granted a priority over the six months claimants unless they possess a valid lien for their tax claims. The Court is of the opinion that the applicable Tennessee statute grants such a lien to these taxing units. Earlier, in **Collier**, *Id.*, it is noted: 'With respect to state taxes, many state statutes grant a priority for claims thereon, and this priority will be recognized by the court.' The statutory priority granted by § 67-801, T.C.A., governs in this case. Therefore, these counties and municipalities will be granted first priority in this recovery, ahead of both the six-months claimants, and the United States, as mortgagee and bondholder."

The District Court also held that Section 3466 (31 U.S.C. § 191) was inapplicable to a railroad reorganization proceeding under Section 77 of the Bankruptcy Act. On appeal the decision was reversed. The Court of Appeals did not reach the issue of priorities, holding rather that Section 3466 was applicable and that a decision on any other priorities was therefore unnecessary. A timely petition for rehearing was denied.

REASONS FOR GRANTING THE WRIT

The claim of the Metropolitan Government was denied by the Court by assigning a higher priority to the claim asserted by the United States Government under R.S. 3466. In doing so the court below has decided an issue of great significance in a way that is contrary to Congressional intent. The court applies Section 3466 in a Section 77 reorganization; and grants priority under Section 3466 to debts arising from loans made by the Reconstruction Finance Corporation which were expressly denied priority by the Congress. We will discuss these two issues in that order.

I

The court below felt compelled to its conclusion by the decision of this Court in **United States v. Key**, 397 U.S. 322, which held that Section 3466 applied with respect to a tax claim by the United States in a Chapter X proceeding. The District Court held that Section 3466 was inapplicable to Section 77 proceedings, and as Judge Weick said in his dissenting opinion:

> "The Court's opinion is based entirely on dicta in **United States v. Key**, 397 U.S. 322 (1970); but **Key** involved a different type of proceeding, namely, a corporate reorganization under Chapter X of the Bankruptcy Act, rather than a railroad reorganization proceeding under Section 77, such as was involved in the present case. Counsel even question the validity of the dicta, pointing out that the court on page 330 quoted Section 77(e), as it existed prior to the Act's amendment in 1935, when the statute was rewritten entirely and drastically changed.
>
> "There is nothing in the Court's opinion to indicate that it considered amended section 77.

"Furthermore, **Key** involved a tax claim of the United States. Our case, unlike **Key**, involved a loan made by R.F.D. to the railroad, which loan was secured by a pledge of $6,216,000 of First Mortgage 4% Bonds. At the time the railroad went into reorganization it owed the Government on the loan $4,571,000 in principal, and $461,731.13 in interest." A-16-A-17.

II

The applicability of R.S. Section 3466 was expressly excluded from Reconstruction Finance Corporation loans since all its powers, functions, rights and liabilities were transferred to the Secretary of the Treasury in 1957. The repeal of the exclusionary section in 1966 by the Omnibus Reorganization Act did not affect the non-applicability of R.S. Section 3466 (31 U.S.C. 191) to the Reconstruction Finance Corporation loans being collected by the Secretary of the Treasury. The issue is of great importance beyond this case. The error of the court below awards the entire estate of the United States Government, and the petitioner's claim of approximately $20,000.00 is wiped out. This sets an important precedent in that cities and counties who depend on this type of taxation for their survival are severely prejudiced.

III

The third and fourth questions presented in this Petition were pretermitted by the action of the court below. It is presumed that if the certiorari is granted and the lower court reversed that these questions will be remanded to the Court of Appeals. However, if this Court elects to pass on these questions it is respectfully requested to so indicate, and petitioner will be afforded the opportunity to brief these issues in its brief on the merits.

CONCLUSION

If either of the questions presented is resolved in favor of the petitioner it will be appropriate to remand the proceeding to the court below, or the judgment of the District Court should be reinstated.

Respectfully submitted

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APPENDIX

The Petitioner, the Metropolitan Government of Nashville and Davidson County, Tennessee, respectively relies on the printed appendix to the Petition for Certiorari filed by Louisville and Nashville Company, Illinois Central Railroad Company, et al., appeared in this proceeding.

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In the Supreme Court of the United States

OCTOBER TERM, 1972

Nos. 71-1680, 72-21, 72-24, 72-62

IN THE MATTER OF TENNESSEE CENTRAL RAILWAY COMPANY, ET AL., PETITIONERS

v.

A. BATTLE RODES, TRUSTEE OF TENNESSEE CENTRAL RAILWAY COMPANY, ET AL.

ON PETITIONS FOR WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals is not yet reported (R.R. Pet. App. 1-20).[1] The opinion of the district court is reported at 316 F. Supp. 1103 (R.R. Pet. App. 21-46).

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[1] "R.R. Pet. App." reference is to the Appendix to the petition filed by the railroads in No. 71-1680.

JURISDICTION

The judgment of the court of appeals was entered on February 2, 1972 (R.R. Pet. App. 1-15). A timely petition for rehearing was denied on April 4, 1972 (R.R. Pet. App. 53). The petitions for writs of certiorari were filed on June 23, 1972, in No. 71-1680, on July 1, 1972, in No. 72-21, on July 3, 1972, in No. 72-24, and on July 11, 1972, in No. 72-62. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTIONS PRESENTED

1. (a) Whether the federal statute giving the United States priority in insolvency proceedings for the debts due to it is applicable in a proceeding under Section 77 of the Bankruptcy Act.

(b) If it is, whether the statute is applicable to a claim of the United States, transferred from the Reconstruction Finance Corporation, which was not entitled to the priority of the United States at the time the loan was made.

2. If the statute is not applicable, whether the claims of "six months" creditors, asserting interline accounts and the furnishing of supplies and services to the railroad before it was placed in reorganization, are entitled to priority in payment ahead of the mortgage bondholders where no current income was diverted to the bondholders.

STATEMENT

The Tennessee Central Railway Company ("the debtor") is in reorganization under Section 77 of the Bankruptcy Act (11 U.S.C. 205); it ceased operations after selling its lines to other carriers. Petitioners are certain of the Tennessee Central's creditors: they are railroads, local government units, and industrial companies. The United States claims priority to the remaining assets of the debtor railroad under the federal insolvency statute (R.S. 3466, 31 U.S.C. 191) and as holder of all of the debtor's first mortgage bonds.

In December 1967, the debtor was placed in reorganization and a trustee was appointed. For several years before the debtor had operated at a loss; its income was insufficient to pay the costs of operation and no payment was made on the fixed charges. The debtor's losses steadily increased during this period from about $204,000 in 1963 to about $1,680,000 in 1967. The total loss during this 5-year period was about $4.5 million (J. App. 30).[2]

At the time the debtor was placed in reorganization, it was in default in the payment of interest on its bonded indebtedness, in payment of its equipment trusts, taxes due to various county and municipal authorities, the payment due to other railroads on interline accounts and per diem charges, and to suppliers. This situation had existed for more than six

[2] "J. App." reference is to the Joint Appendix filed in the court of appeals.

months prior to the commencement of reorganization. As a result of its failure to pay its interline accounts with other railroads, the debtor either had been placed on a pre-payment basis (requiring payment before a connecting carrier would accept shipments, contrary to the ordinary practice) or was in the process of being put in that situation by the other carriers, at the time it was placed in reorganization.

Subsequent to being placed in reorganization, the debtor had no operating profit and was able to continue operation only through the sale of certain assets. This condition continued until August 31, 1968, when the debtor ceased all operations.[3]

The primary claim of the United States arises from two loans to the debtor made by the Reconstruction Finance Corporation ("RFC") and transferred to the Secretary of the Treasury when the RFC was abolished in 1957. At the time the debtor went into reorganization, it owed the United States more than $5,200,000 on these loans.[4]

The railroad petitioners seek recovery for interline claims totalling approximately $900,000, which accrued within the six months before the reorganization petition was filed. The local governments seek recovery of back taxes for periods prior to the filing of the reorganization petition totalling about

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[3] The remaining assets of the debtor, consisting of cash and property, totalled approximately $3 million; the claim of the government was more than $5 million.

[4] The United States also has freight damage, loss and overcharge claims totalling about $60,000.

$105,000.[5] The Koppers Company claims approximately $121,000 based upon the furnishing of crossties, and relies both upon the equitable principle giving priority in certain situations to claims that accrued within six months before receivership, and upon the Tennessee Code Anno. Section 65-1021, which grants priority to certain suppliers of a railroad. Humble Oil also has a claim under the "six months" rule for diesel fuel supplied to the debtor.

The district court held that R.S. 3466 is inapplicable in a Section 77 proceeding and that the interline carriers, suppliers and local taxing authorities have priority over the claim of the United States based on its mortgage bonds (R.R. Pet. App. 21-44). A divided court of appeals reversed (R.R. Pet. App. 1-15). Relying on *United States* v. *Key*, 397 U.S. 322, it ruled that the United States has priority in a Section 77 railroad reorganization proceeding under R.S. 3466 for debts due it over the other claimants involved herein.

ARGUMENT

The principal issue raised by petitioners—whether the priority of the United States under R.S. 3466 applies in railroad reorganizations under Section 77 of the Bankruptcy Act—is settled by *United States* v. *Key*, 397 U.S. 322. The other issues are of little general and even less prospective importance. The

[5] Petition No. 72-62 was filed by Wilson County, Tennessee, after the 90 day jurisdictional time limit applicable in civil cases.

Reconstruction Finance Corporation was abolished 15 years ago, and the two RFC notes involved here are the only ones still outstanding which evidence loans to railroads.

To prevail, petitioners must establish (1) that the United States' insolvency priority under R.S. 3466 is not applicable in railroad reorganization proceedings under Section 77 of the Bankruptcy Act, and (2) that they are within the class of unsecured creditors accorded an equitable priority as "six months creditors," or are otherwise entitled to a priority over the secured government claims. If petitioners fail on either ground, their claims cannot be sustained. The court below rejected petitioners' first contention and thus did not reach the second issue. We submit that this disposition of the case was correct. As noted in footnote 10, *infra*, however, we also believe petitioners' arguments with respect to the second issue are without merit.

1. Section 3466 of the Revised Statutes provides that in the case of an insolvent estate any debts due to the United States shall be "first satisfied." This priority was recently upheld by this Court in a Chapter X reorganization proceeding. The Court noted that Section 77 served as a model for Chapter X, and that "[n]othing in § 77 casts any doubt on the continued priority of the United States under § 3466." *United States* v. *Key*, 397 U.S. at 330. The Court concluded that "§ 3466 must apply according to its terms except where expressly superseded, or where excluded by a later enactment 'plainly inconsistent' with it." (*Id.* at 332).

To support their contention that R.S. 3466 is not applicable in a Section 77 proceeding, petitioners rely on Section 77(b), which provides:

> For all purposes of this section unsecured claims, which would have been entitled to priority if a receiver in equity of the property of the debtor had been appointed by a Federal court on the day of the approval of the petition, shall be entitled to such priority and the holders of such claims shall be treated as a separate class or classes of creditors.[6]

As the court of appeals recognized (R.R. Pet. App. 5), "[t]he difficulty with [petitioners'] argument is that section 77(b) contains no language arguably referring to or superseding the effect of § 3466." That court correctly interpreted the *Key* decision as holding that such an intention is not inferable from generalized provisions or rules dealing with priority in bankruptcy. Instead, these provisions are to be read consistently with R.S. 3466 as allocating the priorities among all creditors except the government. This Court's analysis of the legislative intention also required the result reached below.[7]

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[6] Aside from Section 77(n), pertaining to claims of injured employees, this is the only provision in Section 77 pertaining to priorities.

[7] Petitioners point out that the Court in *United States* v. *Key* was referring to the original Section 77, and not necessarily to Section 77, as amended in 1935 (R.R. Pet. 13-14). However, this Court's statements are fully applicable to the amended Section 77, since nothing in the amendments, nor in the legislative history, suggests any intention to alter the established priority of the United States under Section 3466. Compare this Court's comments with respect to the enactment in 1934 of Section 77B. See 397 U.S. at 331.

2. In addition to contending that R.S. 3466 is never applicable in a Section 77 proceeding, petitioners urge that R.S. 3466 does not apply because the claim of the United States is based upon RFC loans.[8] Petitioners point out that, when the loans were made, the RFC did not have the priority of the United States under R.S. 3466. See 15 U.S.C. (1964 ed.) 603. When the RFC was abolished effective June 30, 1957, by Reorganization Plan No. 1, however, this loan was transferred to the Secretary of Treasury, who has administered the loan since then (J. App. 294).[9] Thus,

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[8] With regard to the RFC aspect of the case, petitioners rely on *United States* v. *Guaranty Tr. Co.*, 280 U.S. 478. While that case has never been explicitly overruled, it is inconsistent with numerous subsequent decisions of this Court in addition to the *Key* case discussed above. See *Massachusetts* v. *United States*, 333 U.S. 611, 624-629; *United States* v. *Remund*, 330 U.S. 539; *United States* v. *Texas*, 314 U.S. 480; *United States* v. *Waddill Co.*, 323 U.S. 353; *Small Business Adm'n* v. *McClellan*, 364 U.S. 446.

[9] Reorganization Plan No. 1 of June 30, 1957, Section 2(d)(1), transferred to the Secretary of the Treasury all of the functions of RFC with respect to or arising out of "programs of financial assistance to railroad companies * * *" (J. App. 297). Section 3 of the plan entitled "Transfer of assets and liabilities" provided that "The loans, obligations, securities, capital stock, and other assets pertaining to the functions transferred by section 2 of this reorganization plan (including accrued interest thereon, and property acquired in connection therewith) and the liabilities, contracts, bonds, mortgages, notes and other instruments relating thereto are hereby transferred from the Corporation to the respective transferees" (*Ibid.*). Section 6 of the Reorganization Plan abolished the Corporation as of June 30, 1957. Since that date, the Department of the Treasury has uniformly treated all debts and obligations as owing to the United States of America.

ten years before petitioners' claims arose, the RFC loan became a claim of the United States. Any recovery on this claim will be deposited in the United States Treasury, and any non-payment is a direct loss to it (J. App. 296).

Even if the derivation of the claim were pertinent, the statute eliminating the RFC's priority was repealed prior to the transactions upon which the competing creditors base their claims. On September 6, 1966, the provision in 15 U.S.C. 603 was repealed, because it was obsolete. H. Rep. No. 901, 89th Cong., 1st Sess., p. 390.

This legislation further provided in Section 8 (80 Stat. 632):

> The laws specified in the following schedule are repealed except with respect to rights and duties that matured, penalties that were incurred, and proceedings that were begun, before the effective date of this Act * * *.

Since none of the petitioners' claims had arisen at the time of the repeal of 15 U.S.C. 603 in 1966, no rights and duties had matured, no penalties had been incurred and no proceedings had begun with respect to this statute. Thus, when petitioners' claim accrued, these loans had the same status as any other claims held by the United States.

Moreover, the source of a claim of the United States is not determinative of the applicability of R.S. 3466. See *United States* v. *Emory*, 314 U.S. 423, where the United States had acquired its claim from a private bank, which had no priority, under a gov-

ernment-guaranteed loan. The government was nevertheless held entitled to priority under R.S. 3466. See also *Wagner* v. *McDonald*, 96 F.2d 273, 275 (C.A. 8):

> Neither is there merit in the first contention; that, because the right of priority did not attach to the notes in the hands of the bank when they were executed, the attribute of priority was not created when they became the property of the United States. Under section 3466, priority of payment does not depend upon how the United States acquired title to the notes, nor upon their status prior to their transfer. Priority is the result of insolvency of the debtor and ownership of the claim by the United States.[10]

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[10] The petitioners' claim of priority over the government as "6 months" creditors was not reached by the court below and not discussed by petitioners. Therefore, no extended refutation of that claim is appropriate. However, under the particular facts of this case the claim is without merit, since there is no fund to which "6 months" creditors can look for payment, and the equitable considerations under which they might establish priority in the absence of such a fund are not present.

CONCLUSION

For the foregoing reasons, it is respectfully submitted that the petitions for writs of certiorari should be denied.

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